The S&P 500 declined 4.35% on September 13th representing the worst single day since the height of the pandemic drawdown. This was precipitated by a headline CPI number coming in higher than expected. These renewed fears of an overly hawkish fed and the potential for sustained inflation. However, are the alternatives to equities viable, and what securities are best positioned in this environment?

We believe dividend growth companies represent an attractive investment alternative.

Cash and fixed income devalue in an inflationary environment, while dividend growth equities can act as an attractive option for investors in this current environment. Equities with high pricing power and capable management teams can provide stronger relative growth prospects from the negative impact of inflation and rising rates. These companies can maintain their margins with the ability to pass along costs to their customers and improve their margins through efficiency improvements brought on by technology. We believe UPS is a good example of a company that is well positioned in the current climate in part due to the ability to pass along cost increases and improve margins through capable management.

United Parcel Service (UPS)

Diversifying the Amazon Risk

UPS and Amazon have reached a contractual agreement on how to split the volume of packages delivered by each company. This does two positive things for UPS. Firstly, with a set contract in place, UPS can reliably forecast its delivery obligations for AMZN parcel volumes to more efficiently allocate network capacity. Second, this more efficient allocation, as well as an overall decrease in AMZN volumes, provides UPS excess network capacity without requiring additional capital expenditures; the company plans to utilize this in higher growth segments, such as Small-to-Medium sized businesses (SMBs), business to business, and healthcare. SMBs have a higher margin than Amazon packages which will allow UPS to expand its operating profit while keeping package volumes more visible. More visible package volumes help the UPS management team maintain the high network utilization that drives operational leverage.

Deal Manager (New Digital Pricing Platform)

The new program “Deal Manager” is a platform that operationalizes UPS’ data and applies pricing science to present customers with the correct price the first time. Prior to this program, the customer had to submit cumbersome data just to get a quote. With this improved process, UPS salespeople can close deals on the spot. The program has completed its rollout to all domestic salespeople and will begin international deployment later this year, starting with Canada and Germany. Deal Manager has already started to demonstrate its value, achieving a win rate of 71% with SMBs which is 12% higher than UPS anticipated. This led to an increase of 3.3% for SMB Average Daily Volume in Q2 2022, well above the Domestic segment’s total ADV trend of -4.0%.

Improving Delivery Density

FedEx, Amazon, UPS, and other logistics companies have made several attempts to improve the density of downstream, particularly last-mile, package delivery with little success. UPS has a new program that utilizes the novel approach of addressing the issue on the opposite side of the network. The program focuses on the upstream network by entering into service-level agreements with e-commerce retailers and manufacturers and integrating into the order management systems of these customers to hold the first order to an address until there is another order going to the same address. These virtual halt agreements are usually 9 to 12 hours, which has shown to be enough time to match packages.

> *Results:* The cost of last-mile delivery for UPS is $5.50 and the incremental packages added only cost $0.60. That is net savings of $4.90 for an incremental package going to the same address. This program is being pushed out to other customers in the third quarter. In the last earnings call, management mentioned the success of the program and their plans to return much of the incremental value back to their customers, creating a more differentiated approach versus competitors and increasing pricing power.

Fuel Pass-Through Charges and Pricing Power

UPS operates one of the largest airlines in the world and has a ground fleet of approximately 127,000 vehicles; as a result, oil and fuel prices have a large impact on its expenses. Though changes in fuel price affect average CPP (cost per piece), fuel surcharges ensure a proportionate impact on average RPP (revenue per piece), resulting in essentially a net-zero impact on the bottom line. UPS applies fuel surcharges to all domestic delivery services. These fuel surcharges allow UPS to pass on shifting fuel prices to customers automatically and easily.

UPS Fuel Surcharges (Year over Year Change)		
	Fuel Surcharge Revenue	Fuel Costs
2nd Quarter	$1.4B	$782m
1st and 2nd Quarter	$2.3B	$1.195B

- Domestic revenue per piece increased 11.9% with fuel surcharges making up 400bps of that increase
- Operating expenses grew by 6.9% with fuel driving 370bps of that increase

Disclosures

This letter may contain "forward-looking statements" which are based on Brookmont's beliefs, as well as on a number of assumptions concerning future events, based on information currently available to Brookmont. Current and prospective clients are cautioned not to put undue reliance on such forward-looking statements, which are not a guarantee of future performance and are subject to a number of uncertainties and other factors, many of which are outside Brookmont's control, and which could cause actual results to differ materially from such statements. All expressions of opinions are subject to change without notice.

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Brookmont Capital is defined as an independent investment management firm that is not affiliated with any parent organizations.

A complete description of Brookmont's performance calculation methodology, including a complete list of each security that contributed to the performance of this Brookmont portfolio is available upon request.

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The Brookmont Dividend Growth Strategy returns are based on an asset-weighted composite of discretionary accounts that include 100% of the recommended holdings. Individual accounts will have varying returns, including those invested in the Strategy. The reasons for this include, 1) the period of time in which the accounts are active, 2) the timing of contributions and withdrawals, 3) the account size, and 4) holding other securities that are not included in the Strategy. Dividends and capital gains are not reinvested. The Strategy does not utilize leverage or derivatives. Returns are based in U.S. dollars. The inception of the Strategy is January 1, 2008.

The Brookmont Dividend Growth Strategy Composite contains fully discretionary accounts with similar value equity investment strategies and objectives. For comparison purposes, the Dividend Growth Strategy Composite is measured against the Russell 1000 Value Index. The Russell 1000 Value Index measures the performance of the large-cap segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The Russell 1000 Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. There is no representation that this index is an appropriate benchmark for such a comparison. You cannot invest directly in an index, which also does not take into account trading commissions and costs. The Volatility of this index may be materially different from the performance of the strategy.

The firm maintains a complete list and description of composites, which is available upon request. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The composite policy requires the temporary removal of any portfolio incurring a client-initiated significant cash inflow or outflow of at least 15% of portfolio assets. The temporary removal of such an account occurs at the beginning of the month in which the significant cash flow occurs and the account re-enters the composite at the beginning of the month which follows the cash flow by at least 30 days. Additional information regarding the treatment of significant cash flows is available upon request.

Brookmont's returns do include reinvestment of dividends and are shown gross-of-fees. All transaction costs are included. The Russell 1000 Value cumulative return includes reinvestment of dividends and capital gains. During a rising market, not reinvesting dividends could have a negative effect on cumulative returns. There is no representation that this index is an appropriate benchmark for such a comparison. You cannot invest directly in an index, which also does not take into account trading commissions and costs. The Volatility of this index may be materially different from the performance of the Strategy.

Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net-of-fees performance was calculated using actual management fees. Additional information regarding the policies for calculating and reporting returns is available upon request.

Your account returns might vary from the composites returns if you own securities that are not included in the Strategy or if your portfolio dollar-cost averaged into the Strategy during the reporting period.

Brookmont Capital Management claims compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of Brookmont's composites and a presentation that adheres to GIPS standards, please contact Suzie Begando at 214-953-0190 or write Brookmont Capital Management, 5950 Berkshire Lane, Suite 1420, Dallas, TX 75225.

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CAPITAL MANAGEMENT

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